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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 714

DICTOGRAPH PRODUCTS, INC., PETITIONER

v.

FEDERAL TRADE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE FEDERAL TRADE COMMISSION IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. 1a–15a [1]) is reported in 217 F. 2d 821.

JURISDICTION

The judgment of the court of appeals (Pet. App. 15a) was entered on December 15, 1954, and a timely petition for rehearing was denied on January 10, 1955. The petition for a writ of certiorari was filed on April 11, 1955. The juris-

[1] The appendix to the petition is cited as "Pet. App." Petitioner's and respondent's appendices in the court of appeals are cited as "Dict. App." and "FTC App.," respectively.

diction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the Federal Trade Commission correctly held that a leading hearing-aid manufacturer's use of exclusive-dealing contracts covering about twenty-two per cent of the "established responsible" distributors of such products violated Section 3 of the Clayton Act and Section 5 of the Federal Trade Commission Act where the proof established that the distributors concerned were prevented to their detriment from dealing in competitors' products and that petitioner's contracts in fact foreclosed its competitors from access to the market served by these distributors.

2. Whether the fact that the number of manufacturers in the industry and total sales of the industry have in the past increased while such exclusive-dealing contracts were in use precluded the conclusion that Section 3 of the Clayton Act and Section 5 of the Federal Trade Commission Act had been violated.

3. Whether the use of such exclusive-dealing contracts was justified as a means of protecting the manufacturer's good will.

STATUTES INVOLVED

Section 3 of the Clayton Act, 38 Stat. 730, 15 U. S. C. 14, provides in part as follows:

> It shall be unlawful for any person engaged in commerce, in the course of such

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> commerce, to * * * make a sale or contract for the sale of goods, wares, merchandise, machinery, supplies, or other commodities * * * on the condition, agreement, or understanding that the * * * purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the * * * seller, where the effect of such * * * sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

Section 5 of the Federal Trade Commission Act, 38 Stat. 717, as amended, 15 U. S. C. 45, provides in part as follows:

> (1) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful.
>
> * * * * *
>
> (6) The Commission is empowered and directed to prevent persons, partnerships, or corporations * * * from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce.

STATEMENT

On May 2, 1949, the Federal Trade Commission issued a complaint charging that petitioner's exclusive-dealing arrangements with its retail dis-

tributors violated Section 3 of the Clayton Act and Section 5 of the Federal Trade Commission Act. After full administrative proceedings, the Commission on September 24, 1953, found that petitioner's practices violated the Acts (Dict. App. 3–29),[2] and issued a cease-and-desist order (Dict. App. 29–32).

The pertinent facts, as found by the Commission, are as follows:

Petitioner is one of the largest manufacturers of hearing aids and parts and accessories in the United States (Pet. App. 16a; Dict. App. 16–17).[3] From 1944 through October 1949, petitioner's aggregate sales of hearing aids totalled approximately $9,260,000, and of parts and accessories approximately $1,200,000 (Par. 5, Dict. App. 18). Petitioner distributes its products by selling them to approximately 220 independently-owned retail distributors, each of whom is given an exclusive sales territory, and each of whom is engaged solely in the business of fitting and selling hearing aids (Par. 4, Dict. App. 17–18). There are approximately one thousand such full-time independent distributors of hearing aids in this country, and they constitute the "best market" for the sale of both hearing aids and accessories (Par. 4, Dict. App. 18).[4]

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[2] The Commission adopted the initial decision of the hearing examiner (Dict. App. 3–29).

[3] Petitioner sells its hearing aids under the trade name "Acousticon" (Par. 2, Dict. App. 17).

[4] The Commission pointed out in its opinion (Pet. App. 19a) that since many hard-of-hearing persons are reluctant

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Since 1937, petitioner has required that its distributors refrain from dealing in hearing-aid instruments and parts and accessories sold and distributed by petitioner's competitors (Par. 6, Dict. App. 18–19). Petitioner also has required that its distributors refrain from selling any used hearing aids (*ibid.*). Petitioner's standard form of contract with its distributors has required the distributor to handle only petitioner's products (Par. 7, Dict. App. 19–22). The contract also provides that either party may terminate the agreement on ten days' notice at any time for any reason, and that in the event of such termination the distributor will not engage in the hearing-aid business within its allotted territory for one year thereafter (*ibid.*).

Petitioner policed its distributors "to determine whether any competitive products were being carried" (Par. 11, Dict. App. 24). Upon discovering that a distributor handled competing products, petitioner threatened immediate dis-

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to wear and will not shop for hearing aids, effective selling of this product requires that potential users be sought out and convinced of its advantages; that well-established distributors specializing in the sale of hearing aids employ a field sales force and concentrate their sales efforts on "locating and selling" potential users, and thus reach a market "not accessible to accounts selling across the counter only"; that such well-established distributors also build up a satisfied clientele which constitutes "an excellent market" for the sale of improved models; and that "effective control" of a substantial number of such distributors is therefore of "great advantage" to a manufacturer of hearing aids.

continuance of the franchise pursuant to the cancellation clause of the contract and, "if any such distributor persisted in carrying any competitive products, he was immediately discontinued" (Par. 12, Dict. App. 24).

As a result of petitioner's exclusive-dealing arrangements, competing manufacturers, the Commission found, "have suffered substantial injury in the form of loss of sales and inadequate distribution of their competing products." Further, competing manufacturers "have been forced to sell less desirable outlets for their products such as optical stores, department stores and drug stores" (Par. 13, Dict. App. 25).[5] Petitioner's distributors, the Commission found, constitute a "substantial segment" of the outlets for sale of hearing aids, and serve "the more important trade areas of the United States," and in such segment petitioner "has effectively established a monopoly" (*ibid.*). The fact that additional competitors have entered the field and that the sales of some competitors have increased during the period when petitioner required its distributors to handle its products exclusively is no defense when "it affirmatively appears that such competitors were foreclosed from a substantial portion of the market" (*ibid.*). Furthermore, the fact that petitioner's products and fitting methods may be superior to those of other hearing-aid manufacturers would not justify pe-

[5] See *supra*, note 4.

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titioner's requiring that its distributors deal only in its products (Par. 14–15, Dict. App. 25–26).

In an accompanying opinion the Commission, after pointing out that by the Clayton Act Congress designated exclusive dealing contracts "an unreasonable restraint on trade where their effect may be to substantially lessen competition", stated that such "test is met here where one of the largest producers in the field has tied up a substantial portion of the established retail outlets with exclusive dealing contracts * * *, and where the contracts not only tend to foreclose a substantial portion of the market to respondent's competitors, but also deny competitive opportunities to respondent's distributors * * * to handle superior or better priced products which may come on the market." (Pet. App. 20a–21.) The Commission also pointed out other relevant marketing factors (Pet. App. 18a–20a), including the fact that during the past 15 years, when the hearing aid industry enjoyed a "tremendous growth" as a result of technical advances, petitioner maintained its position as one of the top three companies in the field and that hearing-aid manufacturers who tried to break into the field during this period were foreclosed from selling to petitioner's distributors and therefore were forced to turn to other non-exclusive distributors and to "less desirable outlets," such as optical, drug, and department stores.

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The Court of Appeals for the Second Circuit (Circuit Judges Chase, Medina, and Harlan) unanimously affirmed the Commission's order. The court (*per* Judge Medina) held that the Commission's findings as to the extent and effect of petitioner's exclusive-dealing agreements were supported by substantial evidence (Pet. App. 3a–4a). The court stated (Pet. App. 5a–9a) that, under the rule of *Standard Oil Co.* v. *United States*, 337 U. S. 293, proof that petitioner's annual business was $2,000,000, that through its exclusive-dealing contracts it had foreclosed competitors from dealing with more than 22% of the nation's "choicest retail outlets for hearing aids," and that it had maintained its position, during a period of substantial growth of the industry, as one of the three top companies, not only supported but virtually compelled a finding that the effect of these agreements "may be to substantially lessen competition or tend to create a monopoly" in violation of Section 3 of the Clayton Act. The fact that the proof also showed that during the period of petitioner's use of these contracts, the number of manufacturers of hearing aids substantially increased, competition was keen, and newcomers to the industry were able to establish themselves did not require a contrary result.

The court further held (Pet. App. 9a–15a) that, in determining whether petitioner's exclusive-dealing practices were illegal, the Commission

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correctly had refused to give weight to petitioner's claim that it produces a superior product and that protection of its good will requires that its distributors be prevented from handling competing products. The court stated (Pet. App. 14a) that the merit of petitioner's product is immaterial, since the only pertinent inquiry under Section 3 is "the probable effect on competition of the use of these restrictive, exclusive-dealing covenants."

ARGUMENT

Petitioner is one of the three largest manufacturers of hearing aids, doing business amounting to about two million dollars a year. It sells its products through retail distributors who are required by petitioner to refrain from dealing in competitive products. The court below unanimously affirmed the conclusion of the Federal Trade Commission that the proof established that, in the context of the hearing-aid industry, petitioner's exclusive-dealing contracts were unlawful under Section 3 of the Clayton Act which prohibits such contracts wherever the effect "may be to substantially lessen competition." The decision below is correct and in accordance with the statute as construed in decisions of this Court. No conflict of decisions in the lower courts is involved. Accordingly, the case presents no question warranting further review by this Court at this time.

1. The Commission and the court below held that as a result of petitioner's exclusive-dealing contracts, which effectively foreclosed competitors of petitioner from access to about twenty-two percent of the "established responsible" hearing-aid distributors,[6] those competitors have been forced to use less desirable outlets for their products, such as optical and department stores, and have "suffered substantial injury in the form of loss of sales and inadequate distribution" (Pet. App. 3a–4a). These findings of injury to competition were reached on a full record[7] which contains

[6] This figure is based on the subsidiary finding that there are approximately one thousand independent full-time distributors of hearing aids, this being the "informed estimate" (Pet. App. 19a) of a Commission witness thoroughly familiar with the industry (see FTC App. 3–7). Petitioner's attack on this estimate (see Pet. 8), which was fully briefed in the court of appeals, was rejected by that court as without merit (Pet. App. 3a). Moreover, proof that petitioner tied up a smaller proportion of the effective outlets would equally establish a violation of Section 3. Cf., *e. g.*, *Standard Oil Co.* v. *United States*, 337 U. S. 293 (discussed *infra*, p. 11); *Richfield Oil Corp.* v. *United States*, 99 F. Supp. 280 (S. D. Calif.), affirmed *per curiam*, 343 U. S. 922 (exclusive contracts between an oil company and retail distributors of 7.56 percent of the gasoline sold in the area violate Section 3).

The substantiality of petitioner's position in the industry was further buttressed by proof that it was one of the three leaders in the industry with annual sales totaling more than two million dollars. Petitioner's suggestion that, in the absence of still further proof, its total sales cannot be called substantial (Pet. 7) is frivolous. Cf. *International Salt Co.* v. *United States*, 332 U. S. 392, 396.

[7] For this reason, petitioner's contention (Pet. 8–10) that the Commission's position herein is inconsistent with its position in *Matter of The Maico Co.* (Docket 5822, decided De-

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abundant and detailed supporting proof from both dealers who were prevented to their detriment from dealing in competitors' products and competitors who were forced to sell through less desirable outlets (see FTC App. 21–22, 24–32, 37–38, 40–46, 51–56, 60, 63–64, 68–70, 74–76, 87–88, 94–97, 123–127, 130–133, 135). As the court below held, this proof would seem "not only to support but virtually to compel a finding that Section 3 has been violated" (Pet. App. 9a).

This case falls well within the ambit of this Court's decision in *Standard Oil Co.* v. *United States,* 337 U. S. 293. That case held (*id.,* p. 314) that proof that the Standard Oil Company had entered into exclusive-dealing contracts with sixteen percent of the independently owned gasoline stations in the relevant competitive area made out a violation of Section 3 of the Clayton Act. The Court there held that the statutory requirement of substantial lessening of competition was satisfied by "proof that competition has been foreclosed in a substantial share of the line of commerce affected."[8]

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cember 7, 1953) is without merit. There the Commission, finding that the hearing examiner had excluded "all evidence relating to the actual competitive effect of respondent's exclusive-dealing requirement" (Op., p. 1), remanded the case "for the development of a record sufficient to enable us to determine the effect of respondent's practices on competition" (*id.,* p. 3). In the instant case, by contrast, the record contains abundant proof of actual foreclosure of competitors and coercion of petitioner's distributors (see text, *supra*).

[8] Petitioner contends that the decision below conflicts with the decision in *Pick Mfg. Co.* v. *General Motors Corp.*, 80 F.

Inasmuch as both the Commission and the Court of Appeals correctly held that petitioner effectively prevented dealers selling its products from selling products of competitors and actually foreclosed competitors from access to a substantial share of the market, this case does not present the question, sought to be raised by petitioner (Pet. 6), whether mere proof that it "enjoyed a substantial share of the market involved" would be sufficient to show a violation of Section 3. In the context of this case, that question is hypothetical and academic.

2d 641 (C. A. 7), affirmed *per curiam*, 299 U. S. 3, under the rule that this Court accepts findings in which two lower courts concur unless clear error is shown. There the lower courts had found that proof of competitive effect had not been established, relying in part on the fact that "the record shows that competition * * * instead of growing less has substantially increased through the period during which the provisions complained of have been in force" (80 F. 2d at 644). There are no comparable findings in the instant case. The record herein shows that the number of competitors had increased and that the total sales of all manufacturers had increased, but also shows, as noted in the text (p. 13, *infra*), that petitioner had maintained its position in the industry during this period of growth and that its competitors had been foreclosed to their damage from the market served by petitioner's distributors. Moreover, in so far as the decision of the court of appeals in *Pick* suggests that proof that the number of competitors has increased is itself inconsistent with a finding of violation of Section 3 of the Clayton Act, the decision has been deprived of any vitality as a precedent by the decision of this Court in *Standard Oil Co.* v. *United States*, 337 U. S. 293, 314.

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2. Petitioner contends that evidence that the number of firms manufacturing hearing aids increased substantially during the period since its exclusive-dealing policy has been in effect and that competition among the various manufacturers and distributors of hearing aids has been active bars a finding that Section 3 has been violated. But the fact that other manufacturers have been able to enter the field and to grow with the industry does not preclude the conclusion that competition has been injured, for, as the court below pointed out (Pet. App. 5a), "the fact remains that petitioner has maintained its position, during all this period of growth of the industry, as one of the top three in the business and at least two other leading manufacturers maintain effective control of a substantial number of established distributors by means of similar restrictive, exclusive-dealing agreements." Compare *Standard Oil Co.* v. *United States*, 337 U. S. 293, where this Court, in rejecting a similar contention advanced in that case, held (at p. 314) that, "[i]n view of the widespread adoption of such contracts by Standard's competitors and the availability of alternative ways of obtaining an assured market, evidence that competitive activity has not actually declined is inconclusive."

Had it not been for petitioner's exclusionary practices, there is no telling how much more the industry might have grown, how many additional companies might have been established, or how

much larger a share of the market petitioner's competitors might have captured. As the Court stated in *Standard Oil,* 337 U. S. at 311, to interpret Section 3 as "requiring proof that competition has actually diminished," which would include inquiry into whether "competition has flourished despite use of the [exclusive-dealing] contracts" (p. 308), would provide "a means of conferring immunity upon the practices which it [Section 3] singles out."

3. Petitioner further suggests that its exclusive-dealing contracts were independently justified as a means of protecting its good will (Pet. 10–11). But, as the court below held in rejecting this contention (Pet. App. 13a–15a), Section 3 invalidates all exclusive-dealing arrangements whose effect "may be to substantially lessen competition or tend to create a monopoly," and if the contracts have the proscribed effect, the reasons which led to their utilization are immaterial. *Cf. Standard Oil Co.* v. *United States,* 337 U. S. at 313–14; *Anchor Serum Co.* v. *Federal Trade Commission,* 217 F. 2d 867, 871 (C. A. 7).

Petitioner relies on four cases which, it contends (Pet. 11), recognize that protection of good will may be a defense in Section 3 proceedings. But in each of those cases the manufacturer sought to prevent the distributors from selling competing products which were to be used in conjunction with its product, on the ground that such use would damage or render inefficient its

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product, and thus damage the manufacturer's good will in that product. In the instant case, however, there is no claim that petitioner's hearing aid would operate less efficiently if petitioner's distributors were permitted to handle competing products. Petitioner claims rather that to permit its distributors to handle competing products "would destroy its efforts to properly present its hearing aids to the purchasing public to its injury and to the injury of the public" (Pet. App. 18a). The court of appeals fully answered this contention. It pointed out (Pet. App. 14a–15a) that if petitioner's product possesses the virtues which petitioner claims for it, "there would seem to be sound business reasons for believing" that "many if not most of petitioner's distributors will voluntarily prefer to deal exclusively with the 'Acousticon' hearing aid and its parts and accessories. * * * But if others, whose clientele may not be composed of so many people of means, desire to take on the products of other manufacturers which command a lower price, even if not of so superior a quality in appearance or performance, and also to sell used instruments which have been traded in or otherwise obtained, the result will be the very result intended by the framers of the statute" (Pet. App. 14a–15a).

CONCLUSION

The decision below is correct and there is no conflict of decisions. No important question of

law is presented calling for review by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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